



**UNIVERSITI PUTRA MALAYSIA**

**PRODUCTIVITY GROWTH  
AMONGST MALAYSIAN FINANCE COMPANIES, 1988-1996**

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**GSM 2001 7**

**PRODUCTIVITY GROWTH  
AMONGST MALAYSIAN FINANCE COMPANIES, 1988-1996**

**By**

**HAZLINA ABD KADIR**

**Thesis Submitted in Fulfilment of the Requirement for the  
Degree of Master of Science  
in the Graduate School of Management  
Universiti Putra Malaysia**

**July 2001**



Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfillment of the requirement for the Degree of Master of Science.

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**Chairman : Associate Professor Muzafar Shah Habibullah, Ph.D**

**Faculty : Graduate School of Management**

Productivity measures are indicators of success, by which the performance of any individual finance company as well as the industry can be gauged. There have been rapid changes in financial industry structure occurring around the world since 1970's. In Asia, countries are restructuring banking regulations and encouraging financial liberalization, in an attempt to increase financial industry efficiency. The financial industry has also undergone multiple growth in new products and facilities in recent years as a result of advances in technology and telecommunications. These developments would have an impact on the competitiveness and hence on the performances of any financial institutions, particularly the Malaysian finance companies.

The aim of this study is to investigate the productivity growth amongst the finance companies in Malaysia from 1988 to 1996. In this context, the study attempts to evaluate the technical efficiency, efficiency change, technical change and productivity of finance companies using the Malmquist index approach and Data Envelopment Analysis. The study of this kind is particularly important to the producers, depositors or customers, investors as well as legislators.

The results indicate that during the period of this study, there is an improvement in productivity of Malaysian finance companies. The productivity growth is mainly associated with the technical change effect rather than technical efficiency change. It also appears that the trend rate of productivity growth accelerated significantly after 1991, following the earlier recession. The results support the Central Bank's call for the financial consolidation of the finance companies.

Abstrak tesis yang telah dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk Ijazah Master Sains.

**PERTUMBUHAN PRODUKTIVITI  
DI KALANGAN SYARIKAT KEWANGAN DI MALAYSIA, 1988-1996**

**OLEH**

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**July 2001**

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Pengiraan produktiviti merupakan salah satu daripada cara untuk mengukur sejauh mana prestasi sesebuah syarikat kewangan. Selain daripada itu, perkembangan industri kewangan keseluruhannya boleh juga diperolehi melalui pengiraan produktiviti. Semenjak tahun 1970an, perubahan pesat telah berlaku di dalam industri kewangan di seluruh dunia. Di Asia, contohnya, banyak negara yang telah menggubal struktur undang-undang perbankan mereka dan telah menggalakkan liberalisasi kewangan di dalam usaha untuk meningkatkan kecekapan sistem kewangan negara masing-masing. Kebelakangan ini pula, didapati industri perbankan telah mempelbagaikan produk bank masing-masing disamping peningkatan kemudahan perbankan rentetan penggunaan teknologi dan sistem telekomunikasi yang terkini. Perkembangan tersebut mungkin mempunyai kesan kepada daya saing dan juga prestasi mana-mana institusi kewangan, termasuklah syarikat kewangan di Malaysia.

Oleh itu, kajian ini telah dijalankan dengan tujuan untuk mengenalpasti tahap pertumbuhan produktiviti di kalangan syarikat kewangan di Malaysia. Di dalam konteks ini, kajian ini ingin menentukan tahap kecekapan teknikal, perubahan kecekapan, perubahan teknikal, dan produktiviti di kalangan syarikat kewangan di Malaysia menggunakan indeks Malmquist dan "Data Envelopment Analysis". Kajian seperti ini adalah penting kepada pengeluar, pendeposit atau pelanggan, pelabur dan juga penggubal undang-undang.

Keputusan kajian menunjukkan tahap produktiviti di kalangan syarikat kewangan di Malaysia telah meningkat di antara tahun 1988 ke 1996. Punca utama kepada peningkatan ini adalah disebabkan oleh peningkatan perubahan teknologi. Keputusan kajian ini juga mendapati, aliran kadar pertumbuhan daya pengeluaran syarikat kewangan di Malaysia telah meningkat dengan ketara selepas tahun 1991 apabila berakhirnya kemelesetan ekonomi yang bermula pada tahun 1985 . Keputusan kajian ini menyokong langkah Bank Negara Malaysia menggalakkan penggabungan syarikat kewangan di Malaysia.

## ACKNOWLEDGEMENTS

Alhamdulillah. Thanks to Almighty Allah without whose blessings, this study would not have been made possible.

My sincere appreciation and gratitude are also conveyed to the Chairman of my thesis committee, Associate Professor Dr Muzafar Shah Habibullah for his patient and persistence guidance, insightful suggestion and support throughout the preparation of this thesis. His continuous guidance and comment had made this thesis a success.

My appreciation is also addressed to the other two committee members, En. Alias bin Radam and Dr. Azali Mohamed for their kind assistance and precious suggestions in improving this thesis. Without their cooperation, this thesis would not have materialized.

My thanks and greatest debt also go to my parents and sisters, thanks for their endless love and support that sees me through. To my husband and son, Mohamad Hisham and Aiman Haikal thanks for their love, support and sacrifices. To my friends and all who have helped in one way or another, I extend my gratitude and thanks.

I certify that an Examination Committee met on 10<sup>th</sup> July 2001 to conduct the final examination of Hazlina Abd. Kadir on her Master of Science thesis entitled "Productivity Growth Amongst Malaysian Finance Companies, 1988-1996" in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulation 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

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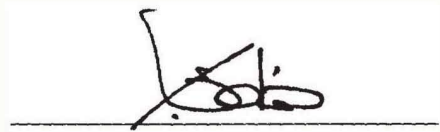
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## DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at Universiti Putra Malaysia or other institutions.



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## TABLE OF CONTENTS

|                        | Page   |
|------------------------|--|
| ABSTRACT               | 2  |
| ABSTRAK                | 4  |
| ACKNOWLEDGMENTS        | 6  |
| APPROVAL SHEETS        | 7  |
| DECLARATION            | 9  |
| LIST OF TABLES         | 12   |
| LIST OF FIGURES        | 14   |
| LISTS OF ABBREVIATIONS | 15   |
| LISTS OF APPENDIXES    | 16   |
| <br>                   |  |
| CHAPTER ONE            | INTRODUCTION   |
| 1.1                    | Introduction 17                                      |
| 1.2                    | Problem Statement 18                                 |
| 1.3                    | Objectives of the Study 21                           |
| 1.4                    | Significance of Study 22                             |
| 1.5                    | Limitations of the Study 23                          |
| 1.6                    | Organization of the Thesis 25                        |
| <br>                   |  |
| CHAPTER TWO            | OVERVIEW OF MALAYSIAN BANKING SYSTEMS                |
| 2.1                    | Introduction 26                                      |
| 2.2                    | Review of Financial Institutions in Malaysia 26      |
| 2.3                    | Finance Companies in Malaysia 32                     |
| 2.4                    | Legislation of Finance Companies 34                  |
| 2.5                    | Performance of Finance Companies 35                  |
| 2.6                    | Consolidation of Finance Companies 40                |
| <br>                   |  |
| CHAPTER THREE          | REVIEW OF LITERATURE                                 |
| 3.1                    | Introduction 45                                      |
| 3.2                    | Conceptual Framework: Productivity and Efficiency 45 |
| 3.3                    | Related Literatures Outside Malaysia 54              |
| 3.4                    | Related Literatures in Malaysia 72                   |
| 3.5                    | Concluding Remarks 75                                |

|                     |                                      |     |
|---------------------|--------------------------------------|-----|
| <b>CHAPTER FOUR</b> | <b>METHODOLOGY</b>                   |     |
| 4.1                 | Introduction                         | 76  |
| 4.2                 | Method of Productivity Measurements  | 76  |
| 4.3                 | DEA Estimation Method                | 83  |
| 4.4                 | Strengths of Malmquist Index and DEA | 88  |
| 4.5                 | Variables Selections and Procedures  | 88  |
| 4.6                 | Sample Sizes                         | 93  |
| <br>                |                                      |     |
| <b>CHAPTER FIVE</b> | <b>RESULTS AND DISCUSSIONS</b>       |     |
| 5.1                 | Introduction                         | 94  |
| 5.2                 | Technical Efficiency                 | 95  |
| 5.3                 | Productivity Indicators              | 108 |
| 5.4                 | Productivity Change                  | 108 |
| 5.5                 | Technical Efficiency Change          | 115 |
| 5.6                 | Technical Change                     | 116 |
| 5.7                 | Asset size vs. Productivity          | 125 |
| <br>                |                                      |     |
| <b>CHAPTER SIX</b>  | <b>CONCLUSION AND SUMMARY</b>        |     |
| 6.1                 | Introduction                         | 127 |
| 6.2                 | Overall summary                      | 127 |
| 6.3                 | Implications of the Study            | 130 |
| 6.4                 | Future Research                      | 133 |
| <br>                |                                      |     |
| <b>BIBLIOGRAPHY</b> |                                      | 134 |
| <br>                |                                      |     |
| <b>APPENDICES</b>   |                                      | 144 |
| <br>                |                                      |     |
| <b>BIODATA</b>      |                                      | 148 |

| <b>LIST OF TABLES</b>   | <b>Page</b> |
|---|-------------|
| Table 2.1    Malaysian Financial Institutions   | 28          |
| Table 2.2    Lists of Finance Companies as at December 31, 1999.  | 37          |
| Table 2.3    Selected Data of Finance Companies   | 38          |
| Table 2.4    Merger Partners of Finance Companies   | 43          |
| Table 2.5    Absorption of the Finance Companies by Commercial Banks  | 44          |
| Table 5.1    Technical Efficiency of Finance Companies: 1988-1996   | 101         |
| Table 5.2    Technical Efficiency of Individual Finance Companies:<br>Statistical data                          | 103         |
| Table 5.3    Technical Efficiency of Individual Finance Companies:<br>1988-1996                                 | 104         |
| Table 5.4    Number of Finance Companies on the Production Frontiers  | 105         |
| Table 5.5    Number of Finance Companies Branches   | 106         |
| Table 5.6    Total Assets vs Technical Efficiency of Finance Companies  | 107         |
| Table 5.7    Average Productivity, Technical Change and Technical<br>Efficiency of Finance Companies: 1988-1996 | 111         |
| Table 5.8    Productivity of Individual Finance Companies   | 113         |
| Table 5.9    AFFIN's Selected Data Rankings   | 114         |
| Table 5.10    Technical Efficiency Change of Finance Companies: 1988-1996                                       | 117         |
| Table 5.11    Technical Efficiency Change of Individual Finance Companies                                       | 119         |

|            |   |     |
|------------|---|-----|
| Table 5.12 | Technical Change Index of Finance Companies: 1988-1996      | 122 |
| Table 5.13 | Technical Change of Individual Finance Companies            | 124 |
| Table 5.14 | Asset Size vs. Productivity of Individual Finance Companies | 126 |



## **LIST OF ABBREVIATIONS**

|                 |   |
|-----------------|---|
| <b>ADV</b>      | <b>Advance Finance Berhad</b>             |
| <b>AFFIN</b>    | <b>Affin Finance Berhad</b>               |
| <b>ARAB</b>     | <b>Arab-Malaysian Finance Berhad</b>      |
| <b>ASIA</b>     | <b>Asia Commercial Finance (M) Berhad</b> |
| <b>BNM</b>      | <b>Bank Negara Malaysia</b>               |
| <b>BUMI</b>     | <b>BBMB Kewangan Berhad</b>               |
| <b>BOLTON</b>   | <b>Bolton Finance Berhad</b>              |
| <b>BSF</b>      | <b>Boon Siew Finance Berhad</b>           |
| <b>CCM</b>      | <b>Credit Corporation (M) Berhad</b>      |
| <b>CEMPAKA</b>  | <b>Cempaka Finance Berhad</b>             |
| <b>CGL</b>      | <b>Chew Geok Lin Finance Berhad</b>       |
| <b>CITY</b>     | <b>City Finance Berhad</b>                |
| <b>DEA</b>      | <b>Data Envelopment Analysis</b>          |
| <b>DELTA</b>    | <b>Delta Finance Company Berhad</b>       |
| <b>DFA</b>      | <b>Distribution Free Approach</b>         |
| <b>EON</b>      | <b>EON Finance Berhad</b>                 |
| <b>FDH</b>      | <b>Free Disposal Hull</b>                 |
| <b>HHF</b>      | <b>Hock Hua Finance Berhad</b>            |
| <b>HLF</b>      | <b>Hong Leong Finance Berhad</b>          |
| <b>HSBC</b>     | <b>HSBC Finance (M) Berhad</b>            |
| <b>INTERF</b>   | <b>Interfinance Berhad</b>                |
| <b>KBB</b>      | <b>Kewangan Bersatu Berhad</b>            |
| <b>KYF</b>      | <b>Kwong Yik Finance</b>                  |
| <b>MAYBAN</b>   | <b>Mayban Finance Berhad</b>              |
| <b>MULTI</b>    | <b>Multi Purpose Finance Berhad</b>       |
| <b>OCBC</b>     | <b>OCBC Finance Berhad</b>                |
| <b>ORIENTAL</b> | <b>Oriental Finance Berhad</b>            |
| <b>OUB</b>      | <b>Overseas Union Trust (M) Berhad</b>    |
| <b>PERDANA</b>  | <b>Perdana Finance Berhad</b>             |
| <b>PHILLEO</b>  | <b>Philleo Allied Finance Berhad</b>      |
| <b>PUBLIC</b>   | <b>Public Finance Berhad</b>              |
| <b>RHB</b>      | <b>RHB Finance Berhad</b>                 |
| <b>SFA</b>      | <b>Stochastic Frontier Approach</b>       |
| <b>SIME</b>     | <b>Sime Finance Berhad</b>                |
| <b>SOUTHERN</b> | <b>Southern Finance Company Berhad</b>    |
| <b>TFA</b>      | <b>Thick Frontier Approach</b>            |
| <b>UMF</b>      | <b>UMBC Finance Berhad</b>                |
| <b>UOF</b>      | <b>United Overseas Finance (M) Berhad</b> |



## **LISTS OF APPENDICES**

**Page**

**Appendix 1 - Total Assets vs. Technical Efficiency of Finance Companies 144**

**Appendix 2 - Total Assets vs. Technical Efficiency Change of Finance**

**Companies 145**

**Appendix 3 - Total Assets vs. Technical Change of Finance Companies 146**

**Appendix 4 - Total Assets vs. Malmquist Index of Finance Companies 147**

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 Introduction**

The purpose of this chapter is to introduce the central theme of this study. This study aims to investigate the productivity growth amongst finance companies in Malaysia. In this context, the study attempts to evaluate if there are any differences in the productivity of finance companies from 1988 to 1996. This study will also identify the sources of productivity changes, is it due to technical change or is it due to efficiency change? These will be accessed using the Malmquist productivity index.

This chapter is divided into four sections. Section 1.2 presents the problem statement, highlighting a brief background to the research. This is followed by Section 1.3, the statement of the intended research objectives. The conceptual framework and general hypotheses are introduced in sections 1.4 and 1.5 respectively. The justification of the study is discussed in section 1.6; while, section 1.7 provides the significance of the study. The last section of this chapter highlights the limitation of the study.

## 1.2 Problem Statement

The financial industry in most economies is so critical that it attracts much attention from the public as well as regulatory authorities. According to Yue (1992), financial institutions perform intermediation functions and consequently influence the level of money stock through their ability to create deposits liabilities. It is critical for depositors, regulators and the public at large to have vested interest in the performance of financial institutions. The study of productivity helps to appraise their performance and provide some insights to which area their productivity and efficiency can be improved.

The banking industry has undergone multiple growth in new products and facilities in these recent years as a result of advances in technology and telecommunications. Technology has contributed to redefining and enhancing bank products so that the banks become more efficient in their daily operations. Starting with the introduction of Automated Teller machine, (ATM), more new bank services such as telephone banking centers, PC banking, direct debit Visa or MasterCard, and Internet Banking are now widely used by many banks. PC banking and Internet banking, provides enormous advantages for the financial institutions, in particular, to reduce cost, increase speed and improve flexibility of business transactions. In addition, the advent of electronic-banking and e-commerce are reshaping the financial institutions by altering their internal operations and their interactions with the customers (Guru and Shamnugam, 1998). These rapid developments would surely have implications

on the performance in general and productivity in particular, of Malaysian finance companies.

Bank Negara Malaysia has stressed to the banking industry, the need for management to play a more effective role in ensuring the financial health of their respective banking institutions. To this extent, recently, BNM has been encouraging the consolidation of the finance industry so that these financial institutions can be highly concentrated and reap the rewards of franchise strengths. The main rationale for change is that the globalization of markets and liberalization of the Malaysian financial sector are inevitable trends. Malaysian financial institutions will face unfettered competition from large foreign multinational banking institutions when our country fully liberalizes the domestic financial services sector (Phuah, 1997).

Mergers and acquisitions may not only leads rise to economies of scale or diversification, but would also benefit bank consumers due to newly merged finance companies being able to take advantage of new technologies or better management and hence providing better products and services at lower costs. In the United States, many of the recent mergers have occurred between profitable banks and bank(s) that are struggling. If the more profitable bank is more efficient and imposes its production structure on the less efficient bank(s), then not only does the consumer gain, but so would the bank owners (English *et al.*, 1993).

In addition, the banking crisis in the mid-1980s had clearly highlighted the vulnerabilities of the weaker banking institutions which are not adequately capitalized to withstand shocks. Against this backdrop, BNM has always recognized the importance of and the need for consolidation in the banking sector in order to attain the critical mass to meet the demands of the changing domestic economic structure, future challenges from globalization and liberalization as well as to contribute towards sustainable economic growth.

A major prerequisite to be able to adjust and adapt to this changing environment is the development of a sound and strong financial system and institutions. For the banking institutions, in rising to this challenge, greater focus on improving efficiency and competitiveness need to be accorded. The importance of achieving critical size, through merger and consolidation of the banking sector, would assume greater significance in order for banking institutions to be able to reap the gains from economies of scale and reduce costs and excess capacity to remain efficient and competitive.

There is yet a comprehensive study on the performance of financial services industry especially in Malaysia, despite the many changes occurred in the banking industry lately. A few studies conducted so far in the Malaysian financial sector tended to subsume industry under the heading of the banking sector as a whole. Therefore, this study is carried out due to the increasing importance of finance industry to Malaysian

economy. This study is also useful as a basis for future research in Malaysian finance companies.

### **1.3 Objectives of the Study**

The main objective of this study is to investigate the performance of the finance companies in Malaysia from 1988 to 1996 using the Malmquist productivity index.

The specific objectives of this study are as follows:

- i. to access the productivity growth amongst finance companies from 1988 to 1996;
- ii. to investigate the source of productivity changes amongst Malaysian finance companies;
- iii. to evaluate yearly performance of finances companies in terms of their efficiency, technical efficiency change, technical change as well as productivity change;
- iv. to identify best practice finance companies in relations to their efficiency, technological progress, technical efficiency change and productivity, and
- v. to compare the productivity, technical change and technical efficiency of finance companies with different asset sizes.



#### 1.4 Significance of the Study

Realizing the multiplicity of financial institution products and in line with the strategic thrust of enhancing competitiveness to meet the challenges of globalization, it is crucial to access and monitor the performance of the financial institutions. The quest for greater efficiency and productivity is never ending as finance companies top management is always under pressure to improve the performance of their companies. Efficiency and productivity study can provide a benchmark of the performance of any individual finance companies in Malaysia as well as the industry as a whole.

The analysis done can compare the relative efficiency, technical efficiency change, technical change and productivity of individual finance companies. There can be considerable differences in the way which individual finance companies combine inputs to produce outputs. In addition there may be differences in potential between finance companies caused by the technology which they have available with them. Using selected variables, this study will identify the best, average and less performers amongst the finance companies. Thus, the efficient and productive finance companies can maintain same level of production, while the less efficient and less productive need to strive for better allocation of resources.

The result obtained can also give an insight on the area that the finance companies need to enhance in order to increase the productivity. Should the finance companies adjust the level of resources such as cutting the operating costs and hiring fewer staff to be more efficient? In terms of technology, this study will access the progress in technology growth. As such, we can identify which finance companies has successfully implemented and used the technology that later lead to increase productivity.

The lesson that has been learnt from the current economic turbulence is that only the fit will survive. In the context of finance companies fitness certainly refers to efficiency and productivity. Thus, the findings of this study would certainly be useful for both finance companies management and policy makers. The result obtained may assist the finance companies and Bank Negara Malaysia, in its efforts to provide the necessary policies to maintain profitability and competitiveness in addition to solvency of finance companies in Malaysia.

### **1.5 Limitations of The Study**

Data from banking sources are difficult to procure. Bankers are guided by legislation to maintain secrecy, and they normally do not dispense freely with information regarding their banking activities. In addition, there is no serious move made by any institutional body or individual to capture data relating to financial institutions in Malaysia. When any finance companies merged, data of earlier finance companies are no longer be available and attainable. The sample for this study includes only 32



finance companies because of limited data available. The data was extracted mainly from annual reports of respective finance companies. Some of the companies may have merged, or resolved during the period of study, thus dropped from the analysis. The accuracy and reliability of the data are highly dependent of the credibility of individual finance companies' reporting.

This study used balance sheet data. Consequently, off-balance sheet activities were ignored. The measures of output do not take quality into account. In particular, neglecting the risk factor, especially for loans (Carlo and Luca, 1995). In addition, financial institutions differ in their definition of financial year-end. Some close their year in March and others in June, October or December. Since this study based on cross-sectional data, such time-lag differences will create a built-in overlap in the data set. To certain extent, this has been minimized, by applying the 'rule of proximity', that is the month of March is considered to be December of the previous year while June and September are considered December of the current year.

In addition, operations and focus of any finance companies may be different. Some finance companies may have their own captive market, for instance, EON Finance, which mainly cater for hire purchase of Malaysian car, which highly differentiate one finance companies to another. Meanwhile, the definition of inputs and output of financial institutions has continued to be a controversial debate. Clark (1984) noted that there is no general consensus regarding the appropriate definition of bank output. This lack of consensus reflected in diversity measures of output employed in